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SUBJECT: ITALY: Telecommunications Sector and Internet
Market - 2004 Update

SUMMARY

1. Italy's telecommunications market is highly developed, liberalized, and mature, particularly in the mobile phone segment. Limited problems remain in the sector, particularly with overlapping EU and national laws, and with regional environmental regulations. Also of some concern is the GOI's continued involvement in the sector. The GOI owns WIND, the main competitor to former incumbent Telecom Italia (TI); and still exercises influence over now fully privatized Telecom Italia. A powerful Communications Ministry often overshadows the role of the independent Communications Authority.

2. Telecom Italia is still the dominant telecommunications company, but its market shares in fixed, mobile, and Internet services are decreasing. Foreign participation, including U.S., is primarily in the mobile phone market; WIND's possible privatization offers a market opportunity for U.S. firms. In the Internet sector, the number of Internet users is growing; and high-speed ISDN lines are systematically replacing traditional fixed lines. Broadband is also rapidly developing. End Summary.

A FULLY LIBERALIZED TELECOM MARKET

3. Communications Ministry and Communications Authority contacts, as well as industry representatives, argue that Italy has created one of the most open and competitive telecom markets in Europe.

4. Our contacts at the Communications Authority provided several examples of the competitiveness of the Italian market. Termination costs have decreased over the last five years by about 30 percent, and are expected to possibly fall even further; number portability is working well, with more than 1.6 million numbers moved from one carrier to another by the end of 2003; and interconnection charges (fixed to mobile) are declining and were in line with the EU average in 2003 (EU average 17.45 cents; Italy 17.47 cents. In 2002, the EU average was 18.92 cents; Italy's was 20.16 cents). Moreover, local loop unbundling is complete; 539,000 lines were "unbundled" at the end of 2003. (Communications Authority senior staff told us Italy's unbundled lines are among cheapest in Europe, and forecast that, as unbundling accelerates, TI and its competitors will increasingly offer advanced services.) Carrier pre-selection is now popular and widespread with over 3.5 million users that have opted for carrier pre-selection by the end of 2003.

A FEW PROBLEMS REMAIN

5. GOVERNMENT'S ROLE: In recent years, a constant concern has been over the GOI's involvement in the sector. Although the GOI sold its residual three percent "golden" shares in Telecom Italia in late 2002, many industry experts believe that TI is still the de facto national communications operator, still receives preferential treatment from the GOI, and that its management decisions are still influenced by the GOI. The Italian Government also owns WIND (Italy's second full-service mobile, fixed line, and Internet - operator) through state-controlled energy conglomerate ENEL. However, industry representatives' criticism has been muted recently, as the GOI has largely been "hands-off" in terms of its involvement with WIND and TI.

6. REGIONAL LAWS: A number of regional governments have passed restrictive environmental provisions that affect telecommunications infrastructure. Each of Italy's twenty regions has, for example, the power to independently establish electronic magnetic emission limits, which can cause difficulties for operators trying to develop countrywide strategies. Similarly, local authorities, at times, have been slow to grant rights-of-way to land they own to telecom companies interested in laying fiber cables or erecting necessary infrastructure. Communications Authority and Communications Ministry officials have downplayed the problem of rights-of-way, and claimed that Italy's telecommunications infrastructure is highly developed and already

can support the vast majority of services.

17. BUREAUCRATIC CONFUSION: The murky line of responsibilities between the Communications Ministry and the Communications Authority also remains. A communications regulator (similar to

the U.S.'s FCC) was created in 1997 to replace entirely the Communications Ministry. However, the Berlusconi Government has not only kept the Ministry intact, but also has strengthened its role, especially in key areas as licensing authority.

THE TELECOM MARKET IN NUMBERS -----

18. Four operators offer mobile services to approximately 55 million subscribers (this includes individuals with multiple subscriptions), representing a 95 percent penetration rate, and with a total mobile market valued at 14.5 billion euros. Ninety percent of subscriptions are through the use of prepaid phone cards. Through its subsidiary TIM (Telecom Italia Mobile), TI owns the lion's share of the market, well over 40 percent, but declining with respect to its 50 percent market share in 2001. Other mobile operators include WIND, Vodaphone (Verizon is its partner), and H3G. The latter is the only provider of 3G services, with approximately 400,000 customers. Although 3G service has begun, market growth potential remains limited. Italian consumers are not convinced that the additional services offered are worth the additional cost. Telecom operators have seen their overall revenues from mobile phone business growing at an estimated annual rate of 2.5 percent. While voice still brings in nearly 85 percent of revenues, data transmission (e.g., text messaging) and other data applications are rapidly growing.

19. Forty fixed line operators (the vast majority being local operators providing business networks) service approximately 29 million customers. The number of fixed lines is still growing, albeit slowly, from 28 million in 2001 to 29 million in 2003. The fixed line market was valued in 2003 at about 17.2 billion euros. Fixed line service providers are moving towards greater specialization with only the largest operators (TI, WIND, Fastweb) offering across the board services. Voice still provides the greatest source of revenue (approximately 75 percent), but Internet and data transmissions are growing rapidly. TI has a 60 percent market share, which is down from its peak share of almost 80 percent in 2001. Traditional PSTN - Public Switched Telephone Networks - lines are being replaced with ISDN lines. In 2001, there were 22.2 million PSTN lines and 5.9 million ISDN lines. By the end of 2003, PSTN lines had decreased to 21.7 million, while ISDN lines were up to 7.2 million.

INTERNET USE -----

110. After a slow start in the late 1990s, Internet use has rapidly grown. There are 23 million users (subscribers) (including business, residents, schools and public offices) compared to only 13 million in 2000. Internet is driving broadband development. According to the Communications Authority, broadband lines are growing faster in Italy than in the rest of Europe; Italy represents approximately 13 percent of Europe's broadband market. The GOI has made significant progress in its goal of bringing broadband to 90 percent of the public sector by the end of 2005.

111. According to Federcomin (Italy's ICT industry association), the Internet is still used largely for e-mail/data transmission and research, with limited business conducted. Italian consumers remain reluctant to put credit card information on the Internet, and still have a limited knowledge of English. According to a recent study, only 20 percent of Italians have sufficient knowledge of the English language to be able to conduct transactions on the Internet. Another significant factor is the Italian retail market. Most Italians, including those living in smaller urban centers, have easy access to small/mid sized retail outlets, as well as banking and insurance services, which makes Internet use/purchases less necessary or desirable. Regarding business-to-business (B2B), Italian small and medium-sized enterprises, the backbone of Italy's economy, reportedly still find it complicated, impractical, and often not economic to move away from traditional purchasing means. Again, though, the situation is evolving.

111. Wi-Fi (Wireless Fidelity) is still in its infancy in Italy. Our contacts believe that it is highly unlikely the public sector will take leadership on Wi-Fi development, although Communications Ministry officials said that the GOI is investing approximately 100 million euros in Wi-Fi development. Communications sector

contacts believe that it will largely be up to the private sector to promote, and invest in, Wi-Fi.

FIXED LINES WILL NOT DISAPPEAR -----

¶12. Just a few years ago, most industry players would have said that fixed lines would become obsolete. This is being reconsidered today. The mobile market is viewed as essentially mature, with limited innovation opportunities and only relative growth potential. On the other hand, with the advent of Internet and broadband development, fixed line applications are growing; and demand for fixed line services is increasing.

Privatization of WIND

¶13. Privatization of WIND had been suspended because of the downturn in capital markets, particularly for telecom operators. With improved market conditions, the GOI as well as ENEL management now seem to eager to sell off WIND. ENEL and WIND senior management have informally approached us regarding possible U.S. interest in the purchase of, or some form of partnership with, WIND.

¶14. Communications Ministry/Authority officials, as well as officials representing communications industry associations, also have called for greater U.S. presence in the sector in Italy. They believe the size and sophistication of the market, with its open regulatory system in place, should attract foreign, and particularly, U.S. investment.

COMMENT

¶15. There is an increasingly firm consensus here among the GOI, the regulator, operators and sector associations - that Italy has a truly open market. The GOI, although still present in the market, has promoted, not hindered, the market's openness, and has brought Italy into compliance with various telecom-related EU directives. After having lagged behind other G7 countries, Italy is catching up in terms of broadband development and greater use of Internet. The mobile telephone market, although a mature market with little room for growth, is among the most sophisticated in the world. Italy is expected to be in the forefront of 3G use, once widespread public services are offered. Fixed network applications still offer, nonetheless, the greatest potential for growth over the coming years in Italy. End Comment.
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